Temporary Emergency Court of Appeals of the United States

No. 5-78

FRANCIS OIL AND GAS, INC., CURTIS S. GREEN, DAVE R. SYLVAN, GEORGE D. DALY, GEORGE B. KAISER, and DON H. NELSON, individually, and on behalf of all other persons similarly situated, collectively, and as a class, PLAINTIFFS-APPELLEES,

v.

EXXON CORPORATION and MARATHON OIL COMPANY, individually and on behalf of all other persons similarly situated, collectively, and as a class, DEFENDANTS-APPELLANTS.

On Appeal from the United States District Court for the Western District of Texas

(P-80-CA-22)

(Argued: June 28, 1982 Decided: August 16, 1982)

DAVID J. BECK, Fulbright & Jaworski, Houston, Texas, with whom David L. Tolin of the same firm; James R. Stevens, Exxon Corporation, Houston, Texas; Robert J. Pickins, Marathon Oil Company, Houston, Texas; and William B. Browder, Jr., Stubbeman, McRae, Sealy, Laughlin & Browder, Midland, Texas, were on the brief, for Defendants-Appellants.

FREDERIC DORWART, Holliman, Langholz, Runnels & Dorwart, Tulsa, Oklahoma, was on the brief, for Plaintiffs-Appellees.

Before INGRAHAM, ESTES and POINTER, Judges.

INGRAHAM, Judge:

This dispute arises out of the unitized oil and gas operations in the Yates Field in Pecos and Crockett Counties, Texas. Francis Oil & Gas, Inc., and various individuals (hereinafter "appellees") sought a declaratory judgment from the district court that the unit agreements governing the Yates Field Unit "did not effect a reallocation and cross-conveyance of the rights to and benefits of stripper well pricing and therefore left the rights to and benefits of stripper well pricing in the owner of the oil and gas rights in respect of the tract from which the oil is produced." On cross-motions for summary judgment, the district court entered summary judgment granting appellees' request. Exxon Corporation and Marathon Oil Company (hereafter "appellants") appeal. We find that the declaration requested by appellees was, to say the least, inaccurate and misleading, and accordingly the declaratory judgment should have been denied. We therefore reverse and remand with instructions to enter summary judgment on appellants' motion.

I — BACKGROUND

"Stripper" wells are generally defined as wells that produce such a small volume of oil that the income derived provides only a small margin of profit, or none at all. See 8 Williams & Myers, Oil and Gas Law 729 (1981). For federal energy regulatory purposes a stripper well is one that produces ten barrels a day or less. *See, e.g.*, 10 C.F.R. § 212.54 (1977). In 1973, at the outset of petroleum price controls, Congress noted that stripper wells accounted for 71% of the total number of wells in the country but only 13% of the total domestic crude production. Conf. Rep. 924, 93d Cong., 2d Sess., *reprinted in* 1973 U.S. Code Cong. & Ad. News 2523, 2532 (Joint Statement of the Committee of Conference on the Trans-Alaska Pipeline Authorization Act of 1973, P.L. 93-153).

Congress desired to provide an incentive for producers to maintain these known sources of domestic crude oil

and keep them in production longer than would ordinarily be economically feasible. *Id.* Accordingly, oil produced from stripper well properties enjoyed a preferred status throughout the history of price controls. We have retraced the treatment of stripper well oil in detail in other contexts, *see, e.g., Sauder v. Department of Energy*, 648 F.2d 1341, 1342-43 (TECA 1981); *Energy Reserves Group, Inc. v. Department of Energy*, 589 F.2d 1082, 1087-91 (TECA 1978). For present purposes it is sufficient to recapitulate that stripper well oil was either entirely exempt from price control, *see, e.g.*, Emergency Petroleum Allocation Act of 1973, § 4(e)(2)(A), Pub. L. 93-159, 87 Stat. 627, 632 (1973), or placed in the "upper tier,"[1] 41 Fed. Reg. 4931, 4940 (Feb. 3, 1976) (codified at 10 C.F.R. § 212.74(a)), from 1973 until the expiration of petroleum price controls in January 1981. Exec. Order No. 12287, 3 C.F.R. 124 (1982).

On February 3, 1976, the Federal Energy Administration (predecessor to the Department of Energy) promulgated Section 212.75(e), 41 Fed. Reg. 4931, 4941 (Feb. 3, 1976), to deal specifically with the problem of inclusion of stripper wells in units such as the Yates Field Unit. Unitization agreements combine the separate tracts in a field so that the field may be operated as a single tract without regard to surface property lines. Unitary operation is particularly appropriate where the reservoir has passed its primary production phase and secondary,

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[1] As Judge Christensen recently explained in *Pennzoil Co. v. Dept. of Energy*, 680 F.2d 156 (TECA), *petition for cert. filed*, 50 U.S.L.W. 3998.20 (June 18, 1982), the federal price control regulations set up a two-tier system to determine the ceiling price for crude oil. The quantity of oil produced in a historical base period was labeled the "base production control level" (BPCL); any current production at or below the BPCL was "old oil" and was priced at the lower tier ceiling; production above the BPCL was "new" oil and could be sold at the upper tier ceiling. For a detailed description of the two-tier system, see the cases collected in *Pennzoil, supra*, at 161.

"enhanced" recovery operations, for example, converting some wells to injection wells and shutting in others, are required to prolong and increase production. *See generally Sauder v. Department of Energy*, 648 F.2d 1341, 1342 (TECA 1981). As the FEA explained, "prior regulations might have discouraged producers of stripper well leases from entering unitization agreements because of the potential loss of the property's uncontrolled (now upper tier) status." 41 Fed. Reg. at 4937. The FEA explained that this loss would occur if the increased production resulting from unitization caused the previously-qualified stripper wells' allocation of crude oil to exceed ten barrels per day. In order to remove this disincentive to unitization, the FEA devised an exemption, subsequently labeled the "imputed stripper well exemption," see 41 Fed. Reg. 48319, 48320 (Nov. 3, 1976) (codified at 10 C.F.R. § 212.75(f)), permitting units to recognize and continue to benefit from the pre-unitization stripper well status of individual tracts. This case requires us to unravel the imputed stripper well exemption for the Yates Field Unit.

Appellees own working interests in Tract 117 in the Yates Field. Prior to July 1, 1976, this property qualified for stripper well treatment and appellees sold forty barrels of crude oil per day from the property at stripper well prices. On July 1, 1976, the Yates Field Unit Agreements became effective and a unit-wide BPCL was calculated. From July 1976 to September 1980, appellees were under contract to sell their share of the Yates Field production to appellant Exxon Corporation. In their certifications[2] to Exxon classifying the production as old,

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[2] Every producer was required by 10 C.F.R. § 212.131 to certify to purchasers the amounts of new, old and stripper oil it was producing for sale, as well as other information. Although appellees have made comments in their brief and during oral argument complaining that Exxon's failure to pay according to their certifications is itself a violation of the

new or stripper oil, appellees continued to count forty barrels per day at the higher stripper well prices. Exxon, however, calculated appellees' share of the imputed stripper well exemption based on information provided by the Unit Operator, appellant Marathon Oil Company; specifically, Exxon applied the "tract participation" allocation formula provided in the unit agreements, thus crediting appellees with a share of the unit's imputed stripper well exemption proportional to the size and historic production of their tract. This share of the imputed stripper well exemption was less than forty barrels per day. Exxon's payments to appellees, accordingly, were lower than the certified amounts, at least with respect to stripper oil.

Appellees brought suit in a Texas state court for a declaratory judgment that they were entitled to sell forty barrels of crude oil per day at stripper prices.[3] Appellants removed the case to the United States District Court for the Western District of Texas. After discovery, briefing and oral argument the district court entered summary judgment (and shortly thereafter an "amended summary judgment") for appellees. The district court adopted appellees' theory that the unit agreements allocate only production and not proceeds (or "pricing benefits"). The underlying question, the district court stated, was the legal status of the stripper wells after unitization. The court concluded, after examining the regulations, that once an individual property qualified for stripper well status it retained that status de-

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applicable regulations, no certification-related question has been litigated or properly raised on appeal in this case and we venture no opinion in that area.

[3] Three related suits were filed in federal and state courts in Oklahoma and Texas. The latest development appears to be *Francis Oil & Gas, Inc. v. Exxon*, 661 F.2d 873 (10th Cir. 1981), in which the Tenth Circuit reversed the dismissal of one of Francis' Oklahoma suits for failure to join indispensable parties.

spite subsequent unitization, and that the "pricing benefits of stripper oil were not unitized and thus were not imputed to the remainder of the interest owners in the unit." Consequently, the court believed that the imputed stripper exemption "does not indicate . . . that stripper oil is automatically imputed to other interest owners if and when the stripper tract unitizes with non-stripper tracts." Because the appellees had done nothing to voluntarily contribute any of their "pricing benefits" to the unit, according to the court, they were still entitled to claim the full pre-unitization forty barrels per day.

II — Appellate Jurisdiction

At the outset appellees argue that this appeal does not fall within the limited statutory jurisdiction of this court. We disagree. Section 211(b)(2) of the Economic Stabilization Act of 1970 granted TECA "exclusive jurisdiction of all appeals from the district courts of the United States in cases and controversies arising under this title or under regulations for orders issued thereunder." 12 U.S.C. § 1904 note (Supp. 1977). This provision was incorporated in section 5(a)(1) of the Emergency Petroleum Allocation Act of 1973, 15 U.S.C. § 754 (a)(1) (1976), which extends TECA jurisdiction to appeals "arising under" the petroleum pricing and allocation regulations. While it is true that TECA has no jurisdiction to consider purely private contract law claims, *see Atlantic Richfield Co. v. Department of Energy*, 655 F.2d 227, 233 (TECA 1981), a damage claim "in the breach of contract sense" that alleges entitlement to a specific price based upon the federal price regulations clearly falls within TECA's jurisdiction. *Mountain Fuel Supply Co. v. Johnson*, 586 F.2d 1375, 1381 (10th Cir. 1978), *cert. denied*, 441 U.S. 952 (1979). We have articulated two principal inquiries: whether resolution of the litigation in its entirety requires the application or interpretation of the Emergency Petroleum Allocation Act and implementing regulations, *Citronelle-*

Mobile Gathering, Inc. v. Gulf Oil Corp., 591 F.2d 711, 716 (TECA), *cert. denied*, 444 U.S. 879 (1979); and whether an EPAA isuse has been adjudicated in the court below. *Texaco, Inc. v. Department of Energy*, 616 F.2d 1193, 1198 (TECA 1979).[4]

In light of these standards our jurisdiction in this case is unmistakable. Appellees claim they are entitled to favorable treatment under a specific federal regulatory provision, the stripper well exemption. Their entitlement to this price or any other, during the period in question, was entirely governed by the federal price control regulations. Appellees candidly represented this reliance on the regulations in, among other places, their Brief in Support of the Named Plaintiffs' Motion for Class Action Certification. This document states that "the case does involve certain pricing rights and benefits which, although allocated by private agreement, are set by federal law," and that there was a "crucial relationship between the (unit agreements) and the federal regulations . . . ." Not only does the claim here rest almost entirely upon the federal regulations, as in *Mountain Fuel Supply, supra*, but it is evident that this dispute can be resolved only through an interpretation of the regulations and that such an interpretation will control the litigation. *Citronelle-Mobile Gathering, supra*, 591 F.2d at 716.

Moreover, as even our brief quotations from the district court's decision indicate, that decision rests significantly on the court's analysis of the federal regulations. The ruling that the imputed stripper well exemption and other regulations did not automatically impute stripper well oil to all interest owners in a unit, for

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[4] *See also United States v. Uni Oil, Inc.*, 646 F.2d 946, 949 (5th Cir. 1981), *cert. denied*, 102 S.Ct. 1254 (1982) (observing that "if the district court adjudicated an EPAA issue, we lack jurisdiction"); *Coastal States Marketing, Inc. v. New England Petroleum Corp.*, 604 F.2d 179 (2d Cir. 1979).

example, is crucial to the court's conclusion that pre-unitization stripper well properties retain their full exemptions upon unitization. An EPAA issue was thereby adjudicated, and TECA is the only court with jurisdiction to review the decision.

III — The Imputed Stripper Well Exemption and The Yates Field

Appellees strenuously argue that this case hinges on an interpretation of the unit agreements, as a matter of state law, and that the federal regulations are "neutral" regarding the outcome. As the preceding discussion of jurisdiction may suggest, however, we believe a relatively straightforward analysis of the federal regulations resolves the case, and that the appellees misapprehend the sense in which the regulations are "neutral."

We begin with the definition of "property." As the Federal Energy Administration observed, "the property concept lies at the heart of the crude oil regulatory scheme." 41 Fed. Reg. 4931, 4938 (Feb. 3, 1976).[5] The stripper well exemption itself applied only to a "property" that produced ten barrels per day per well or less. *See* 10 C.F.R. § 210.32 (1976).[6] Section 210.32 further provided as follows:

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[5] This comment appears in the preamble to 10 C.F.R. § 212.75(e), the first imputed stripper well crude oil exemption. Preambles have considerable explanatory value and we consider them, throughout this discussion, in construing the regulations. *See Wiggins Bros. v. Dept. of Energy*, 667 F.2d 77, 88-89 (TECA 1981), *cert. denied*, —— U.S. —— (1982).

[6] The regulations continuously spoke in terms of "property" despite the various amendments applicable to stripper wells. During the first "exempt" period, from 1973 to February 1976, the definition was contained in 10 C.F.R. § 210.32 and its predecessor, 6 C.F.R. § 150.54(s)(2) (1974). When stripper well crude was moved from exempt into the upper tier from February to September 1976, the applicable section was 10 C.F.R. § 212.72, 41 Fed. Reg. 4931, 4940 (Feb. 3, 1976). In

> "Property" is the right that arises from a lease in existence in 1972 or from a fee interest to produce crude oil in existence in 1972 and is coextensive with the term "property" used in § 212.72 for purposes of determining "base production control level crude oil."

Id. In Ruling 1975-15, the FEA analyzed the definition of property in the context of unitizations. Emphasizing that "the property concept is one that identifies the *right to produce crude oil*" (emphasis in original), and noting that unitization converts production into a single operation, the Ruling concluded that for post-1972 unitizations, "the property consists of the unit, and the BPCL is the total 1972 monthly production from all of the several leases that now comprise the unit." 40 Fed. Reg. 4832 (Sept. 4, 1975). We upheld these interpretations in *Pennzoil Co. v. United States*, 680 F.2d 156 (TECA), *petition for certiorari filed*, 50 U.S.L.W. 3998.20 (June 18, 1982), and *Grigsby v. Dept. of Energy*, 585 F.2d 1069, 1083-84 (TECA 1978), *cert. denied*, 440 U.S. 908 (1979).[1] The principle that a unitized property is a "single property" for regulatory purposes, *Pennzoil* states, is implicit in the property definition itself. 680 F.2d 156 at 167-168. *See also Sauder v. Dept. of Energy*, 648 F.2d 1341, 1343 (TECA 1981); Ruling 1977-2, 42 Fed. Reg. 4409, 4414-15 (Jan. 25, 1977).

In February 1976, the FEA promulgated section 212.75. 41 Fed. Reg. 4931, 4941 (Feb. 3, 1976). Section 212.75 (a) required producers to calculate a "unit base production control level" at the date of implementation of enhanced recovery operations or when the production patterns within the unit were substantially altered. 41 Fed. Reg. at 4941. This provision was simplified in August 1976 to require that "with respect to each

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November 1976, the exemption was reinstated, effective September 1, and the definition codified at 10 C.F.R. § 212.54, 41 Fed. Reg. 48319, 48323 (Nov. 3, 1976).

unitized property, a producer shall, as of the effective date of unitization, establish a *unit* base production control level." 41 Fed. Reg. 36171, 36184 (Aug. 26, 1976) (emphasis added). This language simply makes explicit and concrete the prevailing view that a unit forms a single property for purposes of calculating the various regulatory classificiations in the federal petroleum pricing scheme.

The provision of most importance to us, the imputed stripper well exemption, was contained in section 212.75 (e). This section provided that a producer of crude oil from a unitized property could sell at upper tier prices "a number of barrels equal to the total number of barrels of crude oil produced from each stripper well lease that constitute the unit during the twelve month period immediately preceding the establishment of a unit base production control level, divided by twelve." 41 Fed. Reg. at 4941. The label "imputed stripper well crude oil" was first applied in a November 1976 amendment, which also renumbered the exemption. 41 Fed. Reg. 48319, 48324 (Nov. 3, 1976) (codifying 10 C.F.R. § 212.75(f)).

The plain language of section 212.75 would seem to make clear that a property qualified as a "stripper well lease" prior to unitization would cease to qualify as a separate property, with a separate exemption, upon unitization; however, the unit would still be able to recognize and benefit from the historical stripper well status of some of its constituent parts through the imputed stripper well exemption. If that conclusion was not sufficiently clear from the text of the regulation itself, the preamble removed any further doubt. We have already referred to the preamble in the preceding discussion but a more detailed quotation is appropriate here:

B. PRODUCTION AND SALE OF UPPER TIER CRUDE OIL FROM UNITIZED PROPERTIES

Stripper Well Leases. FEA has determined that prior regulations might have tended to discourage producers of stripper well leases from entering unitization agreements because of the potential loss of the property's uncontrolled (now upper tier) status. For example, if a stripper well lease is unitized with other, non-stripper well leases, the resultant production rate (when the unit production is averaged over the total number of wells in the unit) might exceed 10 barrels per well per day. The producer might be reluctant to enter the unit in that event unless his share of crude oil production were to be increased significantly.

FEA, therefore, proposed an amendment to the regulations in this regard which provides that when a *previously-qualified* stripper well lease has been unitized with other properties (some or all of which are non-stripper well leases), the stripper well lease is *deemed to contribute to the unit* an amount of upper tier crude oil equal to its average daily production of crude oil, excluding condensate recovered in non-associated production, calculated over the twelve month period immediately preceding unitization. For example, if a stripper well lease with five wells had been producing a total of 38 barrels of crude oil per day (averaged over the preceding twelve month period), the same quantity of crude oil would retain its upper tier status when produced from the unit. Therefore, after unitization, 38 barrels per day of crude oil produced from the unit would continue to be classified as upper tier crude oil and could be sold at the upper tier ceiling price, without regard to whether the unit, as a whole, was producing in excess of its BPCL. Such upper tier crude oil deemed to have been produced from a stripper well lease would be in addition to any upper tier crude oil resulting from production in excess of the unit's BPCL.

41 Fed. Reg. at 4937 (emphasis added). This language makes clear that the previously-qualified stripper well leases retain significance only for purposes of calculating the quantity of imputed stripper oil these leases contributed to the unit.

In light of *Pennzoil*, *Grigsby* and the specific provisions of section 212.75 relating to calculation of a unit BPCL, there can be no serious question that the Yates Field was a single property for regulatory purposes and that the quantities of oil falling into the "old," "new" and "stripper" categories had to be calculated on the basis of the unit as a whole. It is inconsistent with this principle for individual tract owners such as appellees to assert calculations based on their pre-unitization behavior as if unitization had never occurred. More importantly, the appellees lost the ability to claim, unilaterally, a stripper well crude oil exemption when their pre-unitization "property" became part of the unit.[7] Appellees put considerable emphasis on the fact that they took their allocation of oil "in kind," pursuant to the unit agreements, and argue that once they had possession of the oil they could sell it as they pleased. This argument completely overlooks the principle that because this oil resulted from a unitized operation it carried with it regulatory classifications computed on the basis of the unit's production as a whole. Simply taking the oil in kind did not allow appellees to revert to pre-unitization pricing, any more than it would allow appellees to ignore price controls altogether.

Appellees also argue that if joining a unit means an individual tract's stripper well exemption is automatically

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[7] Appellants point out another anomaly in appellees' argument; if it is true that pre-unitization tracts retained the ability to claim, on their individual behalf, a stripper well exemption, then *all* the oil produced from Tract 117 would be eligible for stripper pricing; however, appellees only asked for forty barrels per day, although their allocation was over one hundred barrels. Thus, it is difficult to perceive the theory on which appellees made their claim.

imputed to the unit as a whole, which is our holding in this case, then they were forced to "give up" something that no other individual tract owner "gave up" upon joining the unit. Whether this is true as a factual matter is far from clear. In any event we believe that result is mandated by operation of the regulations outlined above, particularly because of the shift from individual to unit "property" upon which the exemption is based, and the preamble language indicating that the individual lease *contributes to the unit* a volume of stripper well oil. Although appellees do not phrase their argument in constitutional terms, the complaint that they were unfairly deprived of a preferential pricing classification is reminiscent of similar arguments we rejected in *Mapco, Inc. v. Carter*, 573 F.2d 1268 (TECA), *cert. denied*, 437 U.S. 904 (1978), and *California v. Simon*, 504 F.2d 430, 437 (TECA) ("On no theory did appellees have a vested right to a continuation of the preferential treatment"), *cert. denied*, 419 U.S. 1021 (1974). As we have seen, the imputed stripper well exemption in fact was an attempt by the federal agency to prevent the total loss of credit for production from previously marginal properties. This does lead, however, to the question that ultimately separates the parties in this case; how should the unit's imputed stripper well exemption be allocated among the participants?

It is in this respect that the federal regulations were intended to be neutral. The preamble to section 212.75, immediately following the description of the imputed stripper well exemption, states:

> Although some comments suggested that FEA prescribe the method for allocating this quantity of upper tier crude oil among the participating leases, FEA has determined that this allocation [is] more properly a matter for private resolution among participants of the unit agreement.

41 Fed. Reg. at 4937. What FEA envisioned is readily apparent: preserving the possibility of a stripper well

exemption would remove any disincentive to unitization on the part of owners of stripper well properties; and these owners could use the prospect of an *imputed* exemption as a bargaining chip to negotiate favorable terms in the unit agreement. Ironically, the district court's ruling (based on its interpretation of the regulations) that only the pre-unitization stripper well property owners retained the imputed exemption was itself an allocation to particular participants; a decision the FEA stated was to be left to private resolution.

Appellant Exxon's exact calculations are not before us and we do not review their mathematical accuracy. However, appellees' insistence that the imputed stripper well exemption was a non-unitized "pricing benefit," and the district court's apparent adoption of that theory, requires a clarification from this court. The imputed stripper well exemption consistently spoke in terms of a number of barrels of oil, an actual volume of production. *See, e.g.*, 10 C.F.R. § 212.75(f) (1977). This classification of production was identical, in that respect, to upper and lower-tier oil under the two-tier price control scheme. The unit agreements specify a formula for allocating the unit's production on the basis of "tract participation." Appellees admit that this formula controlled the allocation of upper and lower-tier oil. Imputed stripper well crude oil, therefore, should have been allocated in the same manner.[8]

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[8] We do not suggest that the allocation of imputed stripper well oil must inexorably follow the same formula as allocation of upper and lower tier oil: the allocation of various categories of production, we emphasize, was within the control of the contracting parties. The Yates Field Unit Agreements, however, were drafted before section 212.75 was adopted and therefore contained no provision specifically referring to the imputed stripper well exemption. The only provision available, the parties both inform us, allocates all categories proportionately according to tract participation. We hold only that imputed stripper well oil is indistinguishable from other categories such as "old" and "new" oil;

IV — Conclusion

The district court's award of summary judgment to plaintiffs-appellees is reversed, and the case is remanded for entry of an order dismissing this cause on the cross-motion for summary judgment by defendants-appellants.

Reversed and Remanded

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accordingly, if a provision for allocating oil exists it must be applied to imputed stripper well oil in the same manner as the other categories, absent express contractual provisions specifying an alternative allocation.

TEMPORARY EMERGENCY COURT OF APPEALS
OF THE UNITED STATES

No. 5-73

FRANCIS OIL and GAS, INC., et al.,
Plaintiffs-Appellees,

v.

EXXON CORPORATION and MARATHON OIL COMPANY,
Defendants-Appellants.

Before HONORABLE JOE McDONALD INGRAHAM, HONORABLE JOE EWING ESTES and HONORABLE SAME C. POINTER, Judges.

JUDGMENT

This cause came to be heard on the record on appeal from the United States District Court for the Western District of Texas and was argued by counsel.

In consideration whereof, IT IS ORDERED that the district court's award of summary judgment to plaintiffs-appellees is reversed, and the case is remanded for entry of an order dismissing this cause on the cross-motion for summary judgment by defendants-appellants.

FOR THE COURT:

DONNA M. BOLD, Clerk

By:

Patricia L. Krosel
Chief Deputy Clerk

August 16, 1982
(District Court
No. P-80-CA-22)

DONNA M. BOLD
CLERK

BY: _____
DEPUTY CLERK

IN THE
UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
PECOS DIVISION

FILED
FEB. 4, 1982
BY CHARLES W. VAGNER,
Clerk

FRANCIS OIL AND GAS, INC., et al.

v.

EXXON CORPORATION, et al.

NO. P-80-CA-22

AMENDED SUMMARY JUDGMENT

On the 12th day of November, 1981, the parties' Motions for Summary Judgment came on to be heard in this court. After considering the relevant authorities, as well as the oral and written arguments of counsel, the Court hereby GRANTS the Plaintiffs' Motion and DENIES the Defendants' Motion.

The parties agree that the facts in this case are undisputed[1] and the case is ripe for disposition as a matter of law. Plaintiffs certified stripper oil to Defendants but Defendants refused to pay them for the full amount of stripper certified. Instead, Defendants paid Plaintiffs for a quanitity of "imputed stripper oil," which was much less than the quantity Plaintiffs claimed and was calculated from the tract participation formula in the unitization agreement.

Plaintiffs claim they are entitled to be paid for the 40 barrels of stripper oil per day to which they were entitled before the unit agreement or the regulations went into effect because neither the unit agreement nor the federal pricing regulations changed their stripper status. Plaintiffs base

[1]See Attachment A.

their claim on the following premises: (1) the unit agreement addresses only allocation of production—not proceeds, (2) the federal pricing regulations concerning "imputed stripper wells" did not destroy the old stripper status; rather, they allowed the transfer of stripper pricing benefits (which had not theretofore been possible) from actual stripper owners who, for whatever reason, wanted to share their stripper pricing benefits with interest owners who had never actually owned stripper wells in the unit. Plaintiffs contend that stripper oil is imputed to other owners in the unit only by express contractual provisions which did not exist in the unit agreement in controversy.

Defendants claim that the tract participation formula in the unit agreement unitizes the oil recovered for purposes of pricing as well as for production allocation; that, in effect, when a stripper well owner joins a unit, his personal advantage of being able to sell stripper oil at unregulated prcies accrues uniformly to the benefit of the other leaseholders in the unit and he, in turn, gains the advantage of being able to increase his production limit. Defendants also contend that actual stripper status ceased to exist in unitized properties the moment the federal regulations created imputed stripper oil. The Court adopts the Plaintiffs' conclusions for the following reasons:

Plaintiffs' wells were qualified as strippers before they were unitized in the Yates Field Unit Agreement.[2] The Unit Agreement was negotiated and executed before federal pricing regulations went into effect. Plaintiffs exercised their right to take production in kind rather than in cash; therefore, there was no reason for either party to introduce any provision regarding the allocation of proceeds in the unit agreement.

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[2]Although Defendants have made some rumblings about the validity of the wells' qualification, they are estopped from controverting it because they used the wells' stripper status in arriving at and allocating imputed stripper oil to the remainder of the unit.

To support the position that the parties did in fact anticipate allocation of proceeds, Defendants rely on language in § 1.14 of the unit agreement which says that oil and gas rights are

> the rights to explore, develop, and operate lands within the Unit Area for the production of Unitized Substances, *or to share in the production so obtained or the proceeds thereof.* (Emphasis added.)

The Court does not agree with Defendants that the emphasized portion of § 1.14 above means that the parties anticipated allocation of proceeds. Rather, the Court construes the section to mean that the intended purpose of the unitization was twofold: (1) "for the production of Unitized Substances" — i.e., to take advantage of increased production benefits allowed those who unitized, and (2) "to share in [either] (a) the production so obtained *or* (b) the proceeds thereof" — i.e., (a) for those who took in kind to share the increased production and (b) for those who took in cash to share the increased proceeds which resulted from the greater production. The Court finds this interpretation to be wholly in keeping with the tenor of the remainder of the agreement and with the parties' considerations at the time of the execution of the agreement. Therefore, it is clear to the Court that the unit agreement does not purport to control allocation of proceeds.

Defendants next contend that Plaintiffs understood at the time they ratified the Unit Agreement that unitization destroyed their stipper status. They support this position with Plaintiff KAISER's admission that he actively lobbied the F.E.A. to promulgate an additional regulation which would preserve stripper status to the original stripper owners; Defendants also point to other unit agreements[3] which have provisions expressly reserving stripper status to

[3]Conroe and Bumpus field unit agreements.

the original owners of stripper wells. Besides inviting intrinsic evidence to the interpretation of an unambiguous contract, both arguments beg the question of the stripper oil's legal status underlying the contract provision and the new regulations. Plaintiffs say, of course, that the purpose of both the Conroe Field Unit provision and Kaiser's lobbying for an additional regulation reserving stripper status to the original stripper owners was simply to reiterate and to make express the existing, underlying status of stripper oil so that the very controversy which has been presented in this case could be avoided. Therefore, the Court has examined the federal pricing regulations, including those proposed by Kaiser and those actually promulgated and has determined that the federal pricing regulations do not and were not intended to apply to any stripper oil which qualifies under 10 C.F.R. §212.54(c), regardless of whether it had been unitized.

Both parties agree that the F.E.A. intended that the allocation of imputed stripper oil is a matter left to private agreement which is controlled by state law. The parties disagree, however, as to whether it was incumbent on Plaintiffs to specifically reserve their original stripper rights to themselves or whether it was incumbent on Defendants to specifically impute Plaintiffs' stripper pricing rights to all other interest owners in the unit.

The F.E.A. specifically exempted stripper oil from federal pricing regulations. 10 C.F.R. §212.54. Nothing in the regulations conditions or otherwise qualifies this exemption. Those owning interests in stripper oil are free to sell it at whatever price they can command. Defendants contend that the stripper exemption applies only to stripper tracts that have not been unitized, although they can point to no language in the regulation which so conditions the exemption. Their best arguments for the unitization of stripper pricing benefits are (1) the arithmetic simplicty of

allocating stripper proceeds in the same way as stripper production is allocated and (2) the fact that Defendants use the same formula for allocating both proceeds and production where similar unit agreements are involved. Neither argument is persuasive; simplicity is not the determinative factor in contract disputes, and litigation of this controversy may not be as valuable to other interest owners as to these Plaintiffs in the Yates Field Unit.

It is clear to the Court that the stripper exemption applies to stripper tracts which have been unitized as well as to those which have not been. The definition of "imputed stripper well crude oil" in 10 C.F.R.§212.75(b) indicates that stripper oil can be imputed *only* in a unitized property. It does not indicate, as Defendants argue, that stripper oil is automatically imputed to other interest owners if and when the stripper trace unitizes with non-stripper tracts. This interpretation of the regulation is consistent with the case law and other authorities cited by Defendants and leads the Court to conclude that neither the unitization agreement nor the federal regulations changed the status of Plaintiffs' stripper oil. The pricing benefits of stripper oil were not unitized and thus were not imputed to the remainder of the interest owners in the unit. The Defendants were in error in imputing Plaintiffs' stripper pricing benefits to other interest owners in the unit, and Plaintiffs are entitled to recover from Defendants for the stripper oil which was imputed to the other interest owners in the unit.

To insure that there is no misunderstanding about the effect of the Court's ruling, the following elementary hypothetical is offered as an example of the difference in allocation of production and allocation of proceeds where stripper and non-stripper properties have been included in the same unit:

> Tract A is a stripper tract; 40 barrels a day qualify for stripper pricing, and A produces 80 barrels a day.

Tracts B and C are non-stripper tracts. B produces 100 barrels a day; C produces 200.

A's tract participation (for production purposes) which is determined by a unit agreement, is 80/380 of the unit; B's tract participation is 100/380; C's is 200/380.

Unless the parties to the unit agreement have expressly agreed that A's stripper oil will be imputed to B and C, only A has any stripper pricing benefits.

This means that A can sell 40 barrels a day at unregulated prices; its other 40 barrels are subject to federal pricing regulations. All of B's and C's oil is subject to federal pricing regulations.

These conclusions are dispositive of the remainder of Defendants' arguments which the Court has found to be without merit.[5]

Accordingly, it is ORDERED, ADJUDGED and DECREED that Plaintiffs recover from the Defendants for their 40 barrels per day of stripper oil and for their costs of court.[6]

SIGNED and ENTERED this 19th day of January, 1982.

LUCIUS D. BUNTON
United States District Judge

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[5]Implicit in the Court's conclusion that the stripper exemption found in §212.54 is unqualified is the conclusion that the regulation establishing a base production control level does not affect stripper status.

[6]Members of the Plaintiff class may not each be entitled to 40 barrels per day, but each is entitled to recover for his respective amount of oil qualifying for stripper pricing.

Attachment A

UNDISPUTED FACTS

(1) The named Plaintiffs own interest in oil and gas which originally was produced from Tract 117 of the Yates Field Unit.

(2) MARATHON OIL COMPANY ("MARATHON") is one of the named Defendants and is the unit operator of the Yates Field Unit. EXXON CORPORATION ("EXXON") is the other named Defendant and, until October, 1980, purchased all the oil allocated to Tract 117 from the named Plaintiffs. MARATHON is the owner of a 49.480235% interest in the Yates Field Unit. EXXON is the owner of a 3.141459% interest in the Yates Field Unit.

(3) MARATHON was the principal drafter of the Yates Field Unit Agreement and the Yates Field Unit Operating Agreement. In negotiating the form of the Unit Agreement, MARATHON initially negotiated with the larger working interest owners and after obtaining the consent of these working interest owners offered the final draft to the small interest owners, including the named Plaintiff FRANCIS, on a take it or leave it basis. FRANCIS opted to take it. The final draft of the Yates Field Unit Agreements, as executed by the large working interest owners, underwent only slight modification when later submitted for approval by the other unit participants. The named Plaintiffs were not part of the small group of working interest owners which executed the Unit Agreement prior to submission of the Agreements to the other unit participants for ratification. The tract participation formula appearing in Section 5.1 of the Unit Agreement was not substantively modified after its initial determination by MARATHON.

(4) MARATHON, EXXON, Chevron Oil Co., Gulf Oil Co., Amoco Production Co., Getty Oil Co., Shell Oil Co., and Continental Oil Co. and a small group of other interest

owners executed the Unit Agreements between June 10, 1975 and July 18, 1975.

(5) The named Plaintiffs ratified the Unit Agreements between August 14, 1975 and Octobert 1, 1975.

(6) The Yates Field Unit was approved by the Texas Railroad Commission and thus became effective on July 1, 1976. At that time, MARATHON OIL COMPANY, as unit operator, established the Unit's base production control level ("BPCL").

(7) Prior to Tract 117's inclusion in the Yates Field Unit, Plaintiffs certified Tract 117 for stripper oil treatment under the applicable federal energy regulations.

(8) The oil allocated by the Unit Agreement to Tract 117 was separately and independently marketed by Plaintiffs. Commencing with the month of July, 1976, and ending with the month of September, 1980, the named Plaintiffs sold all the oil allocated by the Unit Agreement to their Tract 117 to Exxon Company, U.S.A., an unincorporated division of the named Defendant, EXXON CORPORATION. The named Plaintiffs, pursuant to the applicable federal regulation, certified to EXXON the amount of old oil, new oil and stripper oil which they were selling.

(9) The named Plaintiffs certified the Tract 117 oil on the basis that forty barrels per day of Tract 117 oil qualified for stripper well pricing benefits. Forty barrels per day was the amount of stripper oil contributed by Tract 117 upon unitization of the Yates Field Unit.

(10) EXXON's payment was not based on the named Plaintiffs' certifications. Rather, EXXON's payments were determined from calculations based on certain information provided by MARATHON. This information included the Unit's monthly production, BPCL, and total unit amounts of imputed stripper oil, upper tier oil and lower tier oil. Neither MARATHON nor any other party except the

named Plaintiffs purported to certify the Tract 117 production to EXXON. To fix the price payable to the named Plaintiffs for their stripper oil, Defendant EXXON used the tract participation formula promulgated by the unit agreement which specified participation based on the producer's trace size relative to the size of the whole unit rather than the grades of oil and its value. The result of the use of the tract formula was that the amount of stripper well oil allocated to the named Plaintiffs was considerably smaller than the actual amount of stripper oil claimed and certified to the Defendant EXXON. EXXON allocated the benefits of stripper well pricing among all unit participants in the same percentages as are provided by the tract participation formula found in Section 5.1 of the Yates Field Unit Agreement.

(11) When this controvery first arose, EXXON sought an opinion of the Department of Energy that MARATHON was the proper party to certify the production from Tract 117. The Department of Energy rejected EXXON's request and opined that the named Plaintiffs were the proper certifying parties and that the issue whether the named Plaintiffs or the other unit participants were entitled to the stripper well pricing benefits was a question of the private contractual agreements of the parties to be decided by state law.

(12) The Plaintiffs and Defendants agree that the question whether the Yates Field Unit Agreement allocates the benefits of stripper well pricing among all unit participants is a question of Texas law. This action is properly before this Court pursuant to 28 U.S.C. §§1332, 1441.

(13) From the early 1970's until the President's Executive Order of January 30, 1981, the price at which crude oil could be sold was controlled by various federal statutes and regulations. As of November 26, 1973, the Cost of Living Council exempted production from stripper well leases from price controls, and on November 27, 1973, the

Emergency Petroleum Allocation Act provided for a similar stripper well lease exemption. The August 29, 1975, Ruling 1975-15, of FEA, interpreted the manner for the operator to compute a Unit's production/level of low priced oil and high priced oil, and did not mention the effect of unitization upon stripper well leases. The regulatory scheme provided for various pricing categories of crude oil, based in part upon the time of first production and the quantity of the oil produced per well.

(14) Stripper well crude oil is crude oil produced and sold from a stripper well property. A stripper well property is:

> "[a] 'property' whose average daily production of crude oil ... per well did not exceed 10 barrels during any preceding consectuive 12 month period beginning after December 31, 1971." 10 C.R.F. §203.54(c).

(15) Under the regulatory scheme, crude oil produced and sold from stripper well properties could be sold at materially higher prices than other oil. The threat of the loss of stripper well pricing benefits served as a significant disincentive for stripper well property owners to consent to unitization.

(16) On February 3, 1976, the Department of Energy established a special rule applying only to unitized properties, 10 C.R.F. 75(b), which allowed stripper well pricing benefits to be imputed to interest owners in the unit who otherwise had no stripper well pricing benefits, and allowed stripper well pricing to continue to extend to a quantitiy of crude oil equal to the total amount of crude oil produced from all stripper tracts in the year preceding the date of unitization. The sum of all such individual stripper tract volumes was defined as the unit's "imputed stripper well crude oil."

(17) The benefit named Plaintiffs realized immediately after they unitized their interests was a production increase of 89 barrels of oil per day (from 40 to 129).

Department of Energy
Washington, D.C. 20461

Mar. 22, 1978

Received
Mar. 27, 1978
HLR&D

Kenneth P. Fountain, Esquire
Exxon Company, U.S.A.
P.O. Box 2180
Houston, Texas 77001

Re: Request for Interpretation
A-112

Dear Mr. Fountain:

This letter responds to the above-referenced Request for Interpretation filed June 24, 1977 by Exxon Company, U.S.A. (Exxon). In that submission, Exxon requested the Federal Energy Administration (now the Department of Energy) to determine whether 10 CFR 212.131(a)(3) of the Mandatory Petroleum Price Regulations requires Marathon Oil Company (Marathon), as the operator of the Yates Field Unit, to certify the volumes of lower tier ("old"), upper tier "(New") and imputed stripper well crude oil which was sold to Exxon by Francis Oil and Gas, Inc. (Francis), a unit participant and working interest owner that takes its oil in kind. Francis has furnished Exxon with a "certificaiton" on a monthly basis which sets forth the number of barrels of old, new and imputed stripper well crude oil sold by Francis to Exxon the previous month. In its submission Exxon states that it regards these certifications as invalid because they conflict with Marathon's operating reports for the Yates Field Unit and Exxon's understanding of the proportion of imputed stripper well crude oil to which Francis is entitled under the Unit Agreement and Unit Operating Agreement. As a result, Exxon has refused to pay the full amount Francis has claimed for certain crude oil certified as imputed stripper well crude oil after July 1, 1976. On April 21, 1977 Francis

sued Exxon in the United States District Court for the Northern District of Oklahoma (Case No. 77-C--16;-B) for money Francis claims Exxon owes it for this crude oil.

A conference to discuss Exxon's request, attended by representatives of the Department of Energy (DOE), Exxon, Marathon and Francis, was held in Houston on March 8, 1978. After the conference, Exxon orally requested that if the Office of General Counsel (OGC) of DOE determines that Francis is a "producer" as defined in § 212.31 and is therefore required to certify sales of the crude oil it takes in kind from the Yates Field Unit, then the OGC should also resolve that Marathon, as unit operator, is required to allocate the amount of old, new and stripper well crude oil among the unit participants, and that there is a presumption that Francis' certifications must be consistent with Marathon's allocation of crude oil.

The Mandatory Petroleum Price Regulations, 10 CFR 212.31, establish that Francis is a "producer" of crude oil from the Yates Field Unit. That section provides:

> " 'Producer' means a firm or that a part of a firm which produces crude oil or natural gas, or *any firm which owns crude oil* or natural gas *when it is produced.*" (emphasis added)

As a producer, Francis is subject to the requirements of 10 CFR 212.131(a)(3)(i):

> "*With respect to each sale of crude oil* from a unitized property for which the producer has determined a unit base production control level, the producer shall certify in writing to the purchaser the number of barrels of [old, new and imputed stripper well crude oil] ...." (emphasis added)

As shown in Exhibit C of Exxon's Request Francis has furnished the required certifications with respect to Francis' monthly sales of crude oil to Exxon.

The Mandatory Petroleum Price Regulations do not require that Marathon, as unit operator, also certify sales made by Francis, a unit participant and working interest owner. From the facts Exxon has presented, it is clear that although Marathon is also a producer within the meaning of 10 CFR 212.31, it does not sell Francis' crude oil and is thus not subject to the certification requirement of 10 CFR 212.131(a)(3) with respect to sales of Francis' oil.

Moreover, Exxon's question relating to the validity of Francis' certifications in reference to the proportion of stripper well crude oil claimed by Francis is a matter that State law must resolve based upon the written and oral agreements and understandings of the participants in the Yates Field Unit. The DOE regulations do not address the allocation by a unit operator of the amount of old, new and imputed stripper well crude oil amongthe unit participants. The regulations have not adopted any presumption that certifications of crude oil sales by a unit participant and working interest owner taking its oil in kind must be consistent with any such allocation voluntarily made by the unit operator. As stated in the preamble to a rulemaking by the Federal Energy Administration revising the Mandatory Petroleum Price Regulations, 41 FR 4931 (February 3, 1976):[1]

> "Although some comments suggested that FEA prescribe the method for allocating this quantity of upper tier crude oil among the participating leases, FEA has determined that this allocation [is] *more properly a matter for private resolution among the participants of the unit agreement.*" (emphasis added)

Accordingly, Exxon's Request for Interpretation is

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[1]At the time of the publication of this preamble, both new oil and stripper well crude oil were considered to be "upper tier crude oil."

dismissed, since it presents legal issues that must be resolved outside the formal interpretations process.

This letter does not constitute a formal interpretation of the Mandatory Petroleum Price Regulations as contemplated by 10 CFR Part 205, Subpart F.

If you have any questions concerning this letter, please contact Merrill Hathaway of my staff at (202) 566-9070.

Sincerely,

Ezra C. Levine
Acting Assistant General Counsel
for Interpretations and Rulings

cc: Frederic Dorwart, Esquire
Counsel for Francis Oil and
Gas, Inc.

B.L. Walters, Jr.
Warren B. Leach, Esquire
Marathon Oil Company